of the details in connection with the replacement of the property, as required by paragraph (c)(2) of §1.1033(a)–2. The property destroyed in 1970 is insured against loss by fire, but the insurance claim is not satisfied on or before March 1, 1972, the date on which S Corporation acquires all of the assets (including the insurance claim) of R Corporation in a reorganization to which section 381(a) applies. On October 1, 1972, S Corporation receives $12,000 from the insurance company as compensation for the fire loss suffered by R Corporation. Upon receipt of the insurance proceeds, S Corporation realizes a gain of $2,000 upon the involuntary conversion; however, in its return for 1972, S Corporation elects under the provisions of paragraph (c)(2) of §1.1033(a)–2 to have the gain recognized only to the extent provided by section 1033(a)(3). As a result of the replacement by R Corporation, none of the gain realized by S Corporation in 1972 is recognized. Assuming there are no adjustments for depreciation, the replacement property has a basis on October 1, 1972, of $18,000, that is, the cost of such property ($20,000) decreased by the amount of gain not recognized to S Corporation on the involuntary conversion ($2,000)

(d) *Conversion into money when disposition occurs before January 1, 1951.* Section 1033(a)(2) provides that, if property is disposed of in an involuntary conversion before January 1, 1951, and money is received as compensation for the conversion, no gain shall be recognized if such money is forthwith expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund. That section also provides that, if any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended. For example, if, pursuant to section 381(c)(13) and section 1033(a)(2), property of a distributor or transferor corporation is disposed of before January 1, 1951, in an involuntary conversion, and the proceeds from the conversion are received by the acquiring corporation so that the gain on the conversion is realized by that corporation, the acquiring corporation may avoid recognition of the gain if it complies with the provisions of section 1033(a)(2) for nonrecognition of gain. Thus, the acquiring corporation must forthwith expend the proceeds in the acquisition of similar property or stock, or in the establishment of a replacement fund, in order to avoid recognition of the gain, if the disposition occurred before January 1, 1951. See the provisions of §§1.1033(a)–3 and 1.1033(a)–4 relating to involuntary conversions and replacement funds when disposition of the converted property occurred before January 1, 1951.

(e) *Successive acquiring corporations.* An acquiring corporation which, in a transaction to which section 381(a) applies, acquires the assets of a corporation which previously acquired the assets of another corporation in a transaction to which section 381(a) applies, shall be treated as such other corporation for purposes of applying sections 381(c)(13) and 1033 (relating to involuntary conversions). Thus, for example, if any factor essential to the application of section 1033 occurs on or before the date of distribution or transfer in one transaction to which section 381(a) applies, and any other such factor occurs after the date of distribution or transfer in a subsequent transaction to which section 381(a) applies, then the acquiring corporation in such subsequent transaction shall be treated as the first distributor or transferor corporation subject to the rules and limitations of this section for purposes of sections 381(c)(13) and 1033.

[T.D. 6552, 26 FR 1989, Mar. 8, 1961, as amended by T.D. 7075, 35 FR 17995, Nov. 24, 1970]

§ 1.381(c)(14)–1 Dividend carryover to personal holding company.

(a) *Carryover requirement.* Section 381(c)(14) provides that an acquiring corporation shall succeed to and take into account the dividend carryover (described in section 564) of a distributor or transferor corporation in computing its dividends paid deduction under section 561 for taxable years ending after the date of distribution or transfer for which the acquiring corporation is a personal holding company under section 542. To determine the amount of such dividend carryover and to integrate it with the dividend carryover of the acquiring corporation in computing the dividends paid deduction for taxable years ending after the date of distribution or transfer, it is necessary to apply the provisions of section 564 and §1.564–1 in accordance with this section.

(b) *Manner of computing dividend carryover*—(1) *Preceding taxable years.* If the acquiring corporation is a personal holding company under section 542 for its first taxable year ending after the date of distribution or transfer, the taxable year of the distributor or transferor corporation ending with such date is a first preceding taxable year for purposes of section 564, and the taxable year of the distributor or transferor corporation immediately preceding such first preceding year is a second preceding taxable year for purposes of section 564. If the acquiring corporation is a personal holding company for its second taxable year ending after the date of distribution or transfer, the taxable year of the distributor or transferor corporation ending with such date is a second preceding taxable year for purposes of section 564.

(2) *Determination of dividends paid deduction and taxable income.* The dividends paid deduction of any distributor or transferor corporation (determined under section 561 but without regard to any dividend carryover) and the taxable income of any such corporation (adjusted as provided in section 545(b)) for any taxable year ending on or before the date of distribution or transfer shall be determined without reference to any dividends paid deduction, or taxable income, of the acquiring corporation or any other distributor or transferor corporation; in like manner, the dividends paid deduction and the taxable income of the acquiring corporation for any such taxable year shall be determined without reference to any dividends paid deduction, or taxable income, of a distributor or transferor corporation.

(3) *Computation of dividend carryover.* (i) For the purpose of determining the dividend carryover to the first taxable year of the acquiring corporation ending after the date of distribution or transfer, the amount of the dividend carryover from the distributor or transferor corporation shall be determined under section 564 without reference to the dividends paid deduction or taxable income of the acquiring corporation or any other corporation. If two or more transactions to which section 381(a) applies have the same date of distribution or transfer, or if a particular taxable year of the acquiring corporation is the first taxable year ending after the dates of distribution or transfer of two or more such transactions occurring on different dates, the amount of the dividend carryover from each distributor or transferor corporation shall be determined separately as provided in the preceding sentence. Except as provided in subdivision (iii) of this subparagraph, the aggregate of the dividend carryovers from each distributor or transferor corporation and the dividend carryover of the acquiring corporation (computed without regard to this section) shall constitute the dividend carryover under section 561(a)(3) of the acquiring corporation for its first taxable year ending after the date (or dates) of distribution or transfer.

(ii) For the purpose of determining the dividend carryover to the second taxable year of the acquiring corporation ending after the date (or dates) of distribution or transfer, the excess, if any, of the dividends paid deduction (determined under section 561 without regard to any dividend carryover) over the taxable income (adjusted as provided in section 545(b)) for the taxable year of each distributor or transferor corporation and the acquiring corporation referred to as a second preceding taxable year shall be determined separately without reference to the dividends paid deduction or taxable income of any other of such corporations. The excesses thus determined shall be aggregated, and such aggregate shall be—

(*a*) Increased by the excess of the dividends paid deduction (determined without regard to any dividend carryover) over the taxable income (adjusted as provided in section 545(b)), or

(*b*) Reduced by the excess of the taxable income (adjusted as provided in section 545(b)) over the dividends paid deduction (determined without regard to any dividend carryover),

for the first preceding taxable year of the acquiring corporation. Except as provided in subdivision (iii) of this subparagraph, the amount thus determined shall constitute the dividend carryover under section 561(a)(3) of the acquiring corporation for its second taxable year ending after the date (or dates) of distribution or transfer.

(iii) If a particular taxable year of the acquiring corporation is its first taxable year ending after the date (or dates) of distribution or transfer of one or more transactions to which section 381(a) applies, and if the same taxable year of the acquiring corporation is also its second taxable year ending after the date (or dates) of distribution or transfer of one or more other transactions to which section 381(a) applies, then, for the purpose of determining the dividend carryover to such taxable year of the acquiring corporation, the rules contained in both subdivisions (i) and (ii) of this subparagraph shall be applied. Insofar as such taxable year constitutes the first taxable year ending after the date (or dates) of distribution or transfer of any transaction, the amount of the dividend carryover from any distributor or transferor corporation involved in such transaction shall be determined separately as provided in subdivision (i) of this subparagraph. Insofar as such taxable year constitutes the second taxable year ending after the date (or dates) of distribution or transfer of any transaction, the amount of the dividend carryover from any distributor or transferor corporation involved in the transaction and the acquiring corporation shall be determined as provided in subdivision (ii) of this subparagraph. The aggregate of the dividend carryovers thus determined shall constitute the dividend carryover under section 561(a)(3) of the acquiring corporation for such taxable year. See *Example (4)* in paragraph (c) of this section.

(c) *Illustrations*. The rules set forth in paragraphs (a) and (b) of this section may be illustrated by the following examples:

Example (1) —(i) *Facts*. N Corporation acquired on June 30, 1960, all the assets of M Corporation in a reorganization to which section 381(a) applies. Both corporations compute taxable income on the basis of the calendar year. N Corporation is a personal holding company for its taxable years ending December 31, 1960, and December 31, 1961.

(ii) *Dividend carryover to N Corporation's taxable year ending December 31, 1960*. With respect to N Corporation's taxable year ending December 31, 1960, the taxable years referred to as first preceding taxable years and second preceding taxable years are—

(*a*) M Corporation's taxable years ending June 30, 1960, and December 31, 1959, respectively; and

(*b*) N Corporation's taxable years ending December 31, 1959, and December 31, 1958, respectively.

The dividend carryover to N Corporation's taxable year ending December 31, 1960, is $22,000 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

	M Corporation		*N Corporation*
Second preceding taxable year:			
Dividends paid deduction	$25,000		$12,000
Taxable income	15,000		13,000
Excess dividends paid deduction		$10,000	
First preceding taxable year:			
Dividends paid deduction	23,000		20,000
Taxable income	21,000		10,000
Excess dividends paid deduction	2,000		$10,000
Separate dividend carryovers	12,000		10,000

The aggregate dividend carryover of $22,000 is the sum of $12,000 (the separate dividend carryover from M Corporation) and $10,000 (the separate dividend carryover from N Corporation's own preceding taxable years).

(iii) *Dividend carryover to N Corporation's taxable year ending December 31, 1961*. With respect to N Corporation's taxable year ending December 31, 1961, the first preceding taxable year is N Corporation's taxable year ending December 31, 1960; and the taxable years referred to as second preceding taxable years are M Corporation's taxable year ending June 30, 1960, and N Corporation's taxable year ending December 31, 1959. The dividend carryover to N Corporation's taxable year ending December 31, 1961, is $17,000 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

Second preceding taxable year	M Corporation	N Corporation
Dividends paid deduction	$23,000	$20,000
Taxable income	21,000	10,000
Separate excess of dividends paid deduction over taxable income	2,000	10,000

The aggregate excess of dividends paid deduction over taxable income for the second preceding taxable year is $12,000, the sum of $2,000 (separate excess from N Corporation) and $10,000 (separate excess from N Corporation). Such aggregate excess is increased by the excess dividends paid deduction, or is reduced by the excess of taxable income, for the first preceding taxable year as follows:

Aggregate excess of dividends paid deduction for second preceding taxable year		$12,000
Dividends paid deduction of N Corporation for first preceding taxable year	$50,000	
Taxable income of N Corporation for first preceding taxable year	45,000	
		$5,000
Dividend carryover to N Corporation's taxable year ending December 31, 1961		17,000

Example (2) —(i) *Facts*. X Corporation is organized on May 1, 1956, and computes its taxable income on the basis of the fiscal year ending April 30. Y Corporation and Z Corporation are both organized on January 1, 1955, and both compute their taxable income on the basis of the calendar year. On July 31, 1957, X Corporation and Y Corporation transfer all their assets to Z Corporation in a statutory merger to which section 381(a) applies. For its taxable years ending December 31, 1957, and December 31, 1958, Z Corporation is a personal holding company.

(ii) *Dividend carryover to Z Corporation's taxable year ending December 31, 1957*. With respect to Z Corporation's taxable year ending December 31, 1957, the taxable years referred to as first preceding taxable years and second preceding taxable years are—

(*a*) X Corporation's taxable years ending July 31, 1957, and April 30, 1957, respectively;

(*b*) Y Corporation's taxable years ending July 31, 1957, and December 31, 1956, respectively; and

(*c*) Z Corporation's taxable years ending December 31, 1956, and December 31, 1955, respectively.

The dividend carryover to Z Corporation's taxable year ending December 31, 1957, is $40,000 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

	X Corporation		Y Corporation		Z Corporation	
Second preceding taxable year:						
Dividends paid deduction	$56,000		$19,000		$6,000	
Taxable income	24,000		17,000		5,000	
Excess		$32,000		$2,000		$1,000
First preceding taxable year:						
Dividends paid deduction	9,000		4,000		10,000	
Taxable income	7,000		8,000		5,000	
Excess		2,000		(4,000)		5,000
Separate dividend carryovers		34,000		0		6,000

The aggregate dividend carryover of $40,000 is the sum of $34,000 (the separate dividend carryover from X Corporation) and $6,000 (the separate dividend carryover from Z Corporation's own preceding taxable years).

(iii) *Dividend carryover to Z Corporation's taxable year ending December 31, 1958*. With respect to Z Corporation's taxable year ending December 31, 1958, the first preceding taxable year is Z Corporation's taxable year ending December 31, 1957; and the taxable years referred to as second preceding taxable years are X Corporation's taxable year ending July 31, 1957, Y Corporation's taxable year ending July 31, 1957, and Z Corporation's taxable year ending December 31, 1956. The dividend carryover to Z Corporation's taxable year ending December 31, 1958, is $1,000 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

	X Corporation	Y Corporation	Z Corporation
Second preceding taxable year:			
Dividends paid deduction	$9,000	$4,000	$10,000
Taxable income	7,000	8,000	5,000

	X Corporation	Y Corporation	Z Corporation
Separate excess of dividends paid deduction over taxable income	2,000	0	5,000

The aggregate excess of dividends paid deduction over taxable income for the second preceding taxable year is $7,000, the sum of $2,000 (separate excess from X Corporation) and $5,000 (separate excess from Z Corporation). Such aggregate excess is increased by the excess dividends paid deduction, or is reduced by the excess of taxable income, for the first preceding taxable year as follows:

Aggregate excess of dividends paid deduction for second preceding taxable year		$7,000
Dividends paid deduction of Z Corporation for first preceding taxable year	$102,000	
Taxable income of Z Corporation for first preceding taxable year	108,000	(6,000)
Dividend carryover to Z Corporation's taxable year ending December 31, 1958		1,000

Example (3). Assume the facts stated in *Example (2)*, except that Y Corporation transferred all its assets to Z Corporation on May 31, 1957. Assume also that the facts for Y Corporation's taxable year ending May 31, 1957, are otherwise the same as those stated for its taxable year in *Example (2)* ending July 31, 1957. In such case, the dividend carryovers to Z Corporation's taxable years ending on December 31, 1957, and December 31, 1958, are the same as in *Example (2)* notwithstanding the fact that the transfers from X Corporation and Y Corporation occurred on the different dates.

Example (4) —(i) *Facts.* T Corporation acquired on June 30, 1960, all the assets of U Corporation in a statutory merger to which section 381(a) applies, and in a like transaction acquired on June 30, 1961, all the assets of V Corporation. Such corporations all compute taxable income on the basis of the calendar year. T Corporation is a personal holding company for its taxable years 1960 and 1961.

(ii) *Dividend carryover to T Corporation's taxable year 1960.* With respect to T Corporation's taxable year ending December 31, 1960, the taxable years referred to as first preceding taxable years and second preceding taxable years are—

(*a*) U Corporation's taxable years ending June 30, 1960, and December 31, 1959, respectively; and

(*b*) T Corporation's taxable years ending December 31, 1959, and December 31, 1958, respectively.

The dividend carryover to T Corporation's taxable year ending December 31, 1960, is $7,000 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

	U Corporation		T Corporation	
Second preceding taxable year:				
Dividends paid deduction	$16,000		$10,000	
Taxable income	12,000		13,000	
Excess		$4,000		0
First preceding taxable year:				
Dividends paid deduction	7,000		17,000	
Taxable income	5,000		16,000	
Excess		2,000		$1,000
Separate dividend carryovers		6,000		1,000

The aggregate dividend carryover of $7,000 is the sum of $6,000 (the separate dividend carryover from U Corporation) and $1,000 (the separate dividend carryover from T Corporation's own first preceding taxable year).

(iii) *Dividend carryover to T Corporation's taxable year 1961.* Inasmuch as T Corporation's taxable year 1961 is the second taxable year ending after the date of distribution or transfer from U Corporation, paragraph (b)(3)(ii) of this section governs the determination of the dividend carryover from taxable years of T Corporation and U Corporation. On the other hand, inasmuch as T Corporation's taxable year 1961 is the first taxable year ending after the date of distribution or transfer from V Corporation, paragraph (b)(3)(i) governs the determination of the dividend carryover from taxable years of V Corporation.

(*a*) *Application of paragraph (b)(3)(ii) of this section.* With respect to T Corporation's taxable year 1961, the first preceding taxable year is T Corporation's taxable year ending December 31, 1960; and the taxable years referred to as second preceding taxable year are T Corporation's taxable year ending December 31, 1959, and U Corporation's taxable year ending June 30, 1960. The dividend carryover from taxable years of T Corporation and U Corporation is $1,500 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

Second preceding taxable year	U Corporation	T Corporation
Dividends paid deduction	$7,000	$17,000
Taxable income	5,000	16,000
Separate excess of dividends paid deduction over taxable income	2,000	1,000

The aggregate excess of dividends paid deduction over taxable income for the second preceding taxable year is $3,000, the sum of $2,000 (separate excess from U Corporation) and $1,000 (separate excess from T Corporation). Such aggregate is increased by the excess dividends paid deduction, or is reduced by the excess of taxable income, for the first preceding taxable year as follows:

		T Corporation
Aggregate excess of dividends paid deduction for second preceding taxable year		$3,000
First preceding taxable year:		
Dividends paid deduction of T Corporation	$21,000	
Taxable income of T Corporation	22,500	
Excess taxable income		(1,500)
Separate dividend carryover (without regard to V Corporation)		1,500

(*b*) *Application of paragraph (b)(3)(i) of this section.* With respect to T Corporation's taxable year 1961, V Corporation's taxable year ending June 30, 1961, is a first preceding taxable year, and its taxable year ending December 31, 1960, is a second preceding taxable year. The separate dividend carryover from V Corporation is $8,000 computed as follows, assuming the dividends paid deduction before dividend carryovers, and the taxable income after section 545(b) adjustments, to be as stated in the computation:

Second preceding taxable year	V Corporation	
Dividends paid deduction	$11,000	
Taxable income	6,000	
Excess		$5,000
First preceding taxable year:		
Dividends paid deduction	$9,000	
Taxable income	6,000	
Excess	3,000	
Separate dividend carryover from V Corporation		8,000

(*c*) *Dividend carryover.* The dividend carryover to T Corporation's taxable year 1961 is $9,500, the sum of $8,000 (the separate dividend carryover from V Corporation) and $1,500 (the aggregate dividend carryover from T Corporation and U Corporation).

(d) *Successive carryovers.* The provisions of this section shall apply for the purpose of determining a dividend carryover to an acquiring corporation which, in a distribution or transfer to which section 381(a) applies, acquires the assets of a distributor or transferor corporation which has previously acquired the assets of another corporation in a transaction to which section 381(a) applies; even though, in computing the dividend carryover to such second acquiring corporation, it is necessary to take into account the deduction for dividends paid, and the adjusted taxable income, of the first distributor or transferor corporation.

(e) *Acquiring corporation not receiving all the assets.* The dividend carryover acquired from a distributor or transferor corporation by an acquiring corporation in a transaction to which section 381(a) applies is not reduced by reason of the fact that the acquiring corporation does not acquire 100 percent of the assets of the distributor or transferor corporation.

(f) *Dividends paid after the close of taxable year.* A transaction to which section 381(a) applies does not prevent the application of section 563(b) to a dividend paid by a distributor or transferor corporation after the close of its taxable year ending with the date of distribution or transfer but on or before the 15th day of the third month following the close of such taxable year. However, dividends paid by the acquiring corporation may not be taken into account under section 563(b) for the purpose of determining the dividends paid deduction of the distributor or transferor corporation for its taxable year ending with the date of distribution or transfer.

[T.D. 6532, 26 FR 406, Jan. 19, 1961]

§ 1.381(c)(15)–1 Indebtedness of certain personal holding companies.

(a) *Qualified indebtedness*—(1) *Carryover requirement.* If, in a transaction to which section 381(a) applies, the acquiring corporation assumes liability for